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Ohio Department Of Taxation Continues To Update And Issue Ohio Commercial Activity Tax Information Releases And Draft Rules

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The quest to stay current on the Ohio Department of Taxation's ("Department") updates and issuance of rules and information releases on the Commercial Activity Tax ("CAT") continues!

As of the date of this article, the Department has issued 18 Information Releases addressing the CAT – some with more than one version. Each Information Release, the topic it addresses, and any draft or final administrative rule it incorporates is outlined below. Five of the Department's six final rules regarding the CAT (all but the electronic filing and payment rule) and the most recent release defining "taxable gross receipts" are discussed below.

What Has Been Issued So Far

<u>INFO RELEASE</u>	<u>TOPIC</u>
CAT 2005-01	Definition of "Foreign Corporation" Final Rule, Ohio Admin. Code § 5703-29-01, effective December, 2005.
CAT 2005-02	Nexus Standards – September, 2005.
CAT 2005-03	Excluded Person - Consolidated Elected and Combined Taxpayer Groups Final Rule, Ohio Admin. Code § 5703-29-04, effective December, 2005.
CAT 2005-04	Quarterly Taxpayers Must File and Pay Electronically Final Rule, Ohio Admin Code § 5703-29-05, effective December, 2005.
CAT 2005-05	Application of "Common Owners" - Version 3, issued November, 2005, Draft Rule 5703-29-02.
CAT 2005-06	Situsing Rules for Certain Services - Version 4, issued November, 2005.

<u>INFO RELEASE</u>	<u>TOPIC</u>
CAT 2005-07	Transfers of Property Into the State Final Rule, Ohio Admin. Code § 5703-29-06, effective December, 2005.
CAT 2005-08	I.R.C. Section 1221 and 1231 Assets Excluded from "Gross Receipts" – September, 2005.
CAT 2005-09	Sampling Final Rule, Ohio Admin. Code § 5703-29-03, effective December, 2005.
CAT 2005-10	Qualified Foreign Trade Zone Area Final Rule, Ohio Admin. Code § 5703-29-07, effective December, 2005.
CAT 2005-11	Qualified Foreign Trade Zone Area (Additional Information). Revised December, 2005.
CAT 2005-12	Request for Member of a Combined Taxpayer Group to File Separately Final Rule, Ohio Admin. Code § 5703-29-08, effective December, 2005.
CAT 2005-13	Estimated Payments for Calendar Quarter Taxpayers Version 1, Draft Rule 5703-29-09 – October, 2005.
CAT 2005-14	Commercial Activity Tax: Nonprofit Organizations Version 3, Draft Rule 5703-29-10, revised December, 2005.
CAT 2005-15	Change in Registration Status until November, 2005.
CAT 2005-16	Examples of "Common Owners" and Joint Ventures – November, 2005.
CAT 2005-17	"Taxable Gross Receipt" defined – January, 2006.
CAT 2005-18	Temporary Motor Fuel Exemptions Draft Rule 5703-29-12 – November, 2005.

CAT 2005-01 -- Definition of "Foreign Corporation" – Final Rule Effective December 2005

The Department has issued a final rule, Ohio Admin. Code § 5703-29-01, regarding the definition of "foreign corporation" for purposes of CAT.

Pursuant to 26 U.S.C. 7701(a)(3), a "corporation" "includes associations, joint stock companies and insurance companies." Further, "'foreign' when applied to a corporation . . . means a corporation . . . which is not domestic." 26 U.S.C. § 7701(a)(5). "Domestic when applied to a corporation . . . means created or organized

in the United States or of any State" 26 U.S.C. § 7701(4). Therefore, under this rule, the option to exclude or include the gross receipts of a "foreign corporation" from a consolidated elected taxpayer group under R.C. 5751.011(A)(1) is available only if the gross receipts are from a corporation formed outside the United States.

"Foreign corporation" for purposes of R.C. 5751.04 includes:

1. A corporation as defined in R.C. 1703.01 ; or
2. A corporation incorporated under the laws of another state.

Ohio Admin. Code § 5703-29-01(B)(1) and (2). Thus, pursuant to this rule, the requirement to register with the Commissioner for CAT applies only to corporations incorporated in Ohio or in another state.

CAT 2005-07 -- Transfers Into Ohio Of Property Received Outside The State – Final Rule Effective December 2005

Under R.C. 5751.013(A)(1), unless the Tax Commissioner determines that a person's receipt of property outside Ohio and subsequent transfer into Ohio for the person's own use within one year was not intended to avoid the CAT, a person is required to include as a taxable gross receipt the value of such property transferred into Ohio within one year of the date of receipt.

Pursuant to the final rule effective December 2005, Ohio Admin. Code § 5703-29-06, the value of property brought into Ohio within twelve months of its receipt does not have to be included as taxable gross receipt by the purchaser. However, upon audit, if the Commissioner finds that the receipt outside of Ohio was intended in whole or in part to avoid the CAT, he may require the value of the property to be included as a taxable gross receipt. In these circumstances, no penalty will be imposed by the Commissioner.

The Commissioner may identify and post on the Department's website one or more descriptions of transfers that the Commissioner deems are intended to avoid the CAT. If a transfer is one described, a person subject to the CAT must include the value of the property transferred as a gross receipt for the tax period in which the transfer is made. The property is to be valued at its fair market value at the time of transfer. In these circumstances, the taxpayer may file a refund claim and attempt to show that the acquisition and subsequent transfer was not intended in whole or in part to avoid the CAT.

CAT 2005-10 And 2005-11 - Commercial Activity Tax And Qualified Foreign Trade Zones – Final Rule Effective December 2005

The Department has issued a final rule regarding the CAT and Qualified Foreign Trade Zone Areas. See Ohio Admin. Code § 5703-29-07. Uncodified § 557.09.09 of Am. Sub. H.B. 66 ("§ 557.09.09") excludes from gross receipts for purposes of the CAT gross receipts from shipments into and out of a Qualified Trade Zone Area. Ohio Admin. Code

§ 5703-29-07 provides guidance on the conditions under which gross receipts may be excluded from the CAT under § 557.09.09.

In order for shipments to qualify for this exclusion, the Qualified Foreign Trade Zone Area must include a qualified intermodal facility as defined in § 557.09.09(B). "Qualified intermodal facility" is defined as:

[A] transshipment station that is capable of receiving and shipping freight through rail transportation, highway transportation, and air transportation.

Further, "the shipments must be to or from a warehouse or facility that is located within one mile from an international airport and that is located, in whole or in part, within a foreign trade zone as defined in [R.C. 5709.44(A)(2)]." Ohio Admin. Code § 5703-29-07(B). That provision defines a "foreign trade zone" as:

[A] general purpose foreign trade zone or a special purpose subzone for which pursuant to the "Act of June 18, 1934," 48 Stat. 998, 19 U.S.C.A. 81a, as amended, a permit for foreign trade zone status was granted before January 1, 1992, including expansions of and additions to such a zone that are adjacent to the zone as it existed on January 1, 1992, but excluding special purpose subzones for which a permit is granted on or after such date.

In order to help taxpayers identify facilities that meet the requirements for this exclusion, the Commissioner may post on its website maps of international airports that meet the qualifications of § 557.09.09. Any warehouse or facility shown on these maps is deemed, by the Commissioner, to meet the requirements for the exclusion from CAT. Conversely, the taxpayer has the burden of establishing that any warehouse or facility that does not appear on the Department's maps is within the one-mile boundary, and falls within the exclusion. Ohio Admin. Code § 5703-29-07(C).

The Department has determined that the Rickenbacker Airport is an international airport with a qualified intermodal facility. Information Release CAT 2005-11, revised December, 2005. The Department's website includes a map of the Rickenbacker Airport which sets forth the one-mile boundary and indicates the foreign trade zone areas. Any warehouse or facility shown on the Rickenbacker map that is within one mile of the airport boundary and located within a foreign trade zone is deemed to meet the requirements for the exclusion under CAT.

CAT 2005-12 -- Request For Member Of Combined Taxpayer Group To File Separately – Final Rule Effective December 2005

For CAT purposes, the members of a combined taxpayer group (i.e., all persons that have more than 50 percent common ownership) are required to file as one taxpayer. Not infrequently, a member of a combined taxpayer group will not want to share

information with other members of the group. Recognizing this reality, the Commissioner issued a final rule, Ohio Admin. Code § 5703-29-08, pursuant to which a member of a combined taxpayer group may request permission to file a separate CAT return. The procedure doing so is set forth below.

A member that is not the primary taxpayer of a combined taxpayer group, together with the primary taxpayer of the group, must contact the Commissioner and request approval that the member be allowed to file separately from the group. The member and the primary taxpayer must agree to all of the following:

- a) The member will not claim any of the group's exclusion of \$1 million for calendar year taxpayers or \$250,000 for calendar quarter taxpayers, and is not entitled to claim any exclusion of the member's taxable gross receipts on its own behalf.
- b) The member will file as a separate taxpayer and will be subject to the applicable tax rate on all of the member's taxable gross receipts without any exclusion. For example, for the semiannual period July 1, 2005 through December 31, 2005, if a member had \$30,000 of taxable gross receipts, the tax would be \$18, the rate of .0006 times the entire \$30,000 of taxable gross receipts.
- c) The member is financially sound and currently able to pay the CAT and other obligations as determined by the Commissioner.
- d) The member remains jointly and severally liable for the group's tax liability.

Once a request has been made, the Commissioner must provide a copy of his written denial or approval to both the member requesting to file separately and to the primary taxpayer of the combined group. If approved, the separate filing normally starts at the beginning of the next tax period for the combined taxpayer, absent special approval to the contrary.

The Commissioner may revoke separate filing approval at any time.

CAT 2005-17 -- "Taxable Gross Receipt" defined – Issued January 2006

This month the Department issued an information release designed to clarify what constitutes a "taxable gross receipt" for purposes of CAT. As a general rule, the taxpayer starts with the broad definition of gross receipts in R.C. 5751.01(F). This provision broadly defines gross receipts as:

[T]he total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.

R.C. 5751.01(F)(1) provides the following examples of "gross receipts":

- Amounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another;
- Amounts realized from the taxpayer's performance of services for another;
- Amounts realized from another's use or possession of the taxpayer's property or capital;
- Any combination of the foregoing amounts.

To determine "gross receipts" for the tax period, the taxpayer must first subtract any items excluded from "gross receipts." Per R.C. 5751.01(F)(2) the following are excluded from the definition of "gross receipts":

- Interest income, except interest from credit sales. R.C. 5751.01(F)(2)(a).
- Dividends and distributions or distributive or proportionate shares. R.C. 5751.01(F)(2)(b).
- Receipts from the sale or transfer of an asset described in either section 1221 or 1231 of the Internal Revenue Code (generally depreciable capital assets). R.C. 5751.01(F)(2)(c).¹
- Proceeds attributable to the repayment, maturity or redemption of the principal of a loan, bond, mutual fund, certificate of deposit or marketable instrument. R.C. 5751.01(F)(2)(d).
- Principal received under a repurchase agreement or on account of a loan. R.C. 5751.01(F)(2)(e).
- Contributions received by a charitable or religious trust, plan or similar arrangement which are described in Section 501(a) of the Internal Revenue Code. R.C. 5751.01(F)(2)(f).
- Compensation received by an employee. R.C. 5751.01(F)(2)(g).
- Proceeds received from issuance of a taxpayer's own stock, options, warrants, etc. R.C. 5751.01(F)(2)(h).
- Life insurance proceeds. R.C. 5751.01(F)(2)(i).

¹ Information Release CAT 2005-08, issued September, 2005 addresses this exclusion.

- Gifts or charitable contributions, membership dues, and/or payments received for educational courses, meetings, meals or similar payments to a trade, professional or other similar association. R.C. 5751.01(F)(2)(j).
- Damages received from litigation. R.C. 5751.01(F)(2)(k).
- Agent's commission, fee or other remuneration. R.C. 5751.01(F)(2)(l).
- Tax refunds and other benefit recoveries. R.C. 5751.01(F)(2)(m).
- Pension reversions. R.C. 5751.01(F)(2)(n).
- Contributions to capital. R.C. 5751.01(F)(2)(o).
- Sales or use taxes collected. R.C. 5751.01(F)(2)(p).
- Federal and state excise taxes paid on products such as cigarettes or tobacco products, motor fuel, and beer or intoxicating liquors. R.C. 5751.01(F)(2)(q), (r) and (s).
- Sale or transfer of motor vehicle from one dealer to another as customer preference. R.C. 5751.01(F)(2)(t).
- Receipts from a financial institution for services provided to the financial institution regarding the issuance, processing, servicing or managing of loans or credit accounts. R.C. 5751.01(F)(2)(u).
- Administration of anti-neoplastic drugs and other cancer drugs. R.C. 5751.01(F)(2)(v).
- Funds received or used by mortgage brokers. R.C. 5751.01(F)(2)(w).
- Property money and other amounts received by professional employer organizations from client employers. R.C. 5751.01(F)(2)(x).
- Amounts retained as commissions by persons holding permits to conduct horse racing meetings. R.C. 5751.01(F)(2)(y).
- Commission paid by one real estate broker to another real estate broker. R.C. 5751.02(F)(3).
- Temporary motor fuel exemption. Uncodified § 557.09.06 of Am. Sub. H.B. 66.
- Temporary qualified foreign trade zone area exclusion. Uncodified § 557.09.09 of Am. Sub. H.B. 66.

- Any receipts for which imposition of the CAT is prohibited by the Constitution of laws of the United States or of Ohio. R.C. 5751.01(F)(2)(z).

The next step in determining “gross receipts” is to subtract any deductions from the total gross receipts. These deductions are found R.C. 5751.01(4) and are:

- Cash discounts allowed and taken.
- Returns and allowances.
- Bad debts.
- Amount realized from the sale of an account receivable.

The final step is to determine “taxable gross receipts” that are subject to CAT. A “taxable gross receipt” is a “gross receipt” sitused to Ohio. Generally, “gross receipts” are sitused to Ohio based on the benefit to the purchaser. The situsing rules are set forth in R.C. 5751.033 and include the following:

- Gross rents and royalties from real property located in Ohio. R.C. 5751.033(A).
- Gross rents and royalties from tangible personal property located or used in Ohio. R.C. 5751.033(B).
- Gross receipts from the sale of real property in Ohio. R.C. 5751.033(D).
- Gross Receipts from the sale of tangible personal property are sitused based on where the property is ultimately received. R.C. 5751.033(E).
- Gross Receipts from the sale, exchange, disposition or other grant of the right to use trademarks, trade names, patents, copyrights and similar intellectual property are sitused based on either the amount of use in Ohio or the right to use the property in Ohio. R.C. 5751.033(F).
- Gross receipts from transportation services by common carrier are sitused to Ohio by proportionate mileage in state. R.C. 5751.033(G).
- Gross receipts from other services are sitused to Ohio in proportion to purchaser's in-state benefit of those services. R.C. 5751.033(I).

In November, 2005, the Department issued version 4 of the draft rule for situsing other services. This release addresses the situsing rules for specific services and provides examples of how the “gross receipts” are sitused to Ohio.



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